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SUBJECT: KAZAKHSTAN: PREPARING FOR FUTURE ROUND OF OFFSHORE OIL TENDERS?

REF: ASTANA 738

Classified By: Pol-Econ Chief Deborah Mennuti; reasons
1.4 (b) and (d).

¶1. (C) Summary: In early 2006, the Government of Kazakhstan granted a small geophysical company, Caspian Veritas LLP, exclusive rights to acquire seismic data over the entire "open" (unassigned) acreage of the Kazakhstani sector of the Caspian Sea. The company -- and at least one major prospective client -- believe this data will be used to launch Kazakhstan's first-ever round of "open" tenders for offshore fields, perhaps as early as late 2007. Moving to an open tender system would be consistent with the 2005 Production Sharing Agreement Law, which grants priority to an open tender system. In the current system, individual companies are invited to negotiate their participation in a project with KazMunaiGaz (KMG), the national oil and gas company. Energy Minister Izmukhambetov, however, has spoken publicly of delaying new tenders indefinitely, focusing the GOK's resources instead on developing existing fields and finalizing contracts already under negotiation. A Shell executive, experienced in competing -- and winning -- in the current system, believes the "direct negotiation" approach is well-suited to Kazakhstan and unlikely to change in the near future. End summary.

Kazakhstani Law -- and Current Practice

¶2. (C) Kazakhstan's July 2005 Production Sharing Agreement (PSA) Law was the first legislation to systematically outline a process for assigning offshore rights. (Of course, PSAs had been signed prior to passage of the law, at Kashagan, Karachaganak, Tyub-Karagan, and Kurmangazy.) The law specifies three ways in which offshore blocks can be assigned. The "primary" method is by open or closed tender -- though, to date, none have been held. The PSA Law also grants the GOK the right to assign blocks, without tender, if provided for by treaty or to "fulfill other obligations" of the State. (This process was used in creating the Kurmangazy PSA. Kurmangazy straddles the Kazakhstani/Russian Caspian boundary line, and thus presented treaty implications.) Finally, the PSA Law allows the "national company" (KazMunaiGaz) to obtain fields by "direct negotiations" with MEMR, and then subsequently to seek a "strategic partner" (without tender) to participate in field development. This process, in fact, has been pursued in all of the offshore projects currently being negotiated with foreign oil companies.

¶3. (C) The passage of the PSA Law spurred much speculation

that, with the fundamental tender rules outlined and codified, the GOK would soon prepare an open tender for an offshore field. On several occasions since the passage of the law, however, Energy Minister Izmukhambetov has announced the GOK's intent to indefinitely postpone the tender process, in favor of concentrating on concluding ongoing negotiations and developing existing projects -- notably, Kashagan -- in which KMG is already a partner. Many oil executives here subscribe to the theory, implicit in Izmukhambetov's statements, that KMG lacks the institutional capacity to manage more offshore projects, and/or the finances to uphold its share of further offshore projects.

Shell Articulates Advantages of Direct Negotiations

¶4. (C) With a share in Kashagan and offshore Zhemchuzhnaya, and an apparent lock on participation in the "N Block" project (reftel), Shell has arguably had more recent success in securing offshore Kazakhstani prospects than any other company. On December 8, Martin Ferstl, Shell's Country Chairman, shared his impressions of the process with Econoff.

Ferstl suggested that the GOK preferred having companies negotiate directly with KMG, rather than conducting open tenders, because the former process allowed KMG to negotiate with several companies at once. This benefited KMG early in the process, he said, because it allowed KMG to see each company's seismic data set -- and thus compensate for the fact that the GOK often did not have independent access to the best data in existence. After seeing each company's data set, Ferstl continued, KMG would acquire the technical knowledge of the block in question well enough to conduct intelligent negotiations over the financial terms for access to the process. Finally, he said, KMG benefited from having

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two or more project finalists bid against one another, because KMG was more likely to receive a fair bid that way than if it had to evaluate a series of tender bids against the technical baseline of a project that it did not understand very well.

¶5. (C) To succeed in the current system, Ferstl continued, a company had to establish good personal relationships with Kazakhstani energy insiders. Over time, he explained, the Kazakhstani offshore had come to be divided into separate "fiefdoms" associated informally with the one (or more) companies which had demonstrated persistent interest. These companies tended to be the ones invited into negotiations with KMG. This relationship-oriented process, Ferstl argued, fit Kazakhstan's culture better than the "objective," bureaucratic approach of a formal tender -- one reason, he said, why the GOK was unlikely to adopt the open tender process in the near future.

¶6. (C) At the same time, Ferstl described the Kazakhstani system of direct negotiation with KMG as "immensely frustrating." Shell had spent four-and-a-half years negotiating access to the "N Block," he cited by way of example, while in most countries "a tender process would be concluded in six months." Part of the reason for the long process, he said, was that the GOK was in no hurry to develop the offshore Caspian. Ferstl cited the shortage of institutional resources (para. 3) as one example, along with the idea that the GOK's cash flow from current projects meets the GOK's development goals.

Seismic Data Acquisition Project

¶7. (C) Despite the GOK's established preference to assign blocks via direct negotiation, there are those who believe an open tender process is on the horizon. In early 2006 the Ministry of Energy and Mineral Resources (MEMR) concluded an agreement with Veritas Caspian LLP (a 50/50 joint venture between Salt Lake City-based Caspian Services, Inc., and

Veritas DCG of Houston) giving Veritas Caspian an exclusive right to obtain seismic data over the entire open (unassigned) acreage of the Kazakhstani sector of the Caspian. Veritas Caspian also secured the right to market the data for ten years on behalf of the GOK, which it will do by creating a seismic data database available for purchase by interested oil companies. Veritas Caspian recently completed its first season of work, shooting approximately 660 kilometers of 2D seismic data in the "Chagala" area of the Caspian -- just South of the super-giant Kashagan field. Veritas Caspian has largely funded its seismic acquisition project by offering "subscriptions" to oil companies. In return for an upfront, one-time payment, subscribers are allowed input into which sectors of the sea Veritas Caspian will shoot first and most comprehensively, along with preferential access to the finished data, which will eventually be distributed to any interested buyer.

¶8. (C/NF) Terrance Powell, Caspian Services' Vice President for Investor Relations, told Econoff that oil companies had eagerly paid to become "subscribers" to the service, and at least one oil major had "screamed bloody murder" after being told they had missed the deadline to participate. Peter Claypoole, ExxonMobil's Manager for New Business Development, told Econoff that his company was an eager "subscriber" to the process, and expected that the seismic data would be used to launch future rounds of open tenders for offshore blocks. ExxonMobil, he added, was extremely interested in the "Primorsk" block (estimated 2 billion barrels) of the Chagala area, and was eagerly awaiting the completed data package and an anticipated tender. Powell told Econoff that his company had been told that the seismic data would be used as the basis for an "open tender" round, perhaps as early as year-end 2007, but acknowledged that MEMR had sent conflicting signals about its intent.

¶9. (C) Comment: While the seismic data database being built could, presumably, give KMG the technical expertise it currently lacks to conduct an open tender, it would not appear to necessitate a change in the current process for assigning offshore blocks. If, as Ferstl indicated, the GOK is comfortable linking the assignments process to various "soft" considerations, including interpersonal relationships and, presumably, Kazakhstan's broader geopolitical concerns, then a continuation of the status quo might be the most likely outcome. End comment.

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